1987

12 Tips To Make Tax Reform Pay Off For You

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12 TIPS TO MAKE TAX REFORM PAY OFF FOR YOU

"Tax Reform" Doesn't Mean "Tax Reduction"

Tax reform has been hailed, hated, praised and panned. But whatever its merits or shortcomings may be, tax reform shouldn't be confused with tax reduction. In fact, even if you are careful, you could pay more taxes under tax reform this year than you did without tax reform last year. That doesn't have to be the case. With some year-end tax planning, you could make tax reform pay off for you.

How Tax Reform Affects You

A married couple filing jointly with a combined taxable income of $32,000 could wind up paying more taxes this year than last. Careful year-end tax planning may help reduce their tax burden.

Tax Planning Secrets

For many people, the key tax planning words are: defer income and accelerate expenses. Simply put, you may want to put off receiving income while pre-paying deductible expenses. While that may seem like a sure way to the poorhouse, done properly, it can significantly reduce your tax burden for 1987.

Delay Now, Save Later

The reason this strategy may work for you in 1987 is that the tax reform act phases in new lower tax rates over two years. This phase-in means that the rates for 1988 are significantly lower than 1987 rates. So by delaying income until next year, you could wind up paying less tax on that income. At the same time, tax deductions will be worth less next year because the taxes they offset will be lower.

Consult A Professional

Tax planning is a complicated task. Before you commit yourself to any one strategy, it is best to consult a knowledgeable tax professional. If you don't already use a certified public accountant, your state CPA society can recommend one in your area.

ACCELERATE TO SAVE

1 Miscellaneous expenses–Under tax reform, miscellaneous expenses must exceed two percent of your adjusted gross income before you can deduct them. But miscellaneous expenses can mount quickly. Do some quick calculations to see if you are over or near the two percent limit. If so, prepaying some expenses–such as buying new uniforms now instead of next year–could save you tax dollars. Other miscellaneous expenses include union and professional dues, tax preparation fees, safe deposit box fees and investment counsel fees among others.

Bonus Tip: If you had a job related move or looked for a new job in 1987, any expenses you incurred are deductible, provided you itemize. Deductible expenses include travel, resume printing and preparation, and postage.

2 Medical expenses–Under tax reform, medical expenses must now exceed 7.5 percent of your adjusted gross income before you can deduct them, up from five percent last year. However, you still may be able to benefit from this deduction. If your expenses are at or near the limit, you may want to stock up on prescription drugs if your doctor and pharmacist allow.

3 Charitable contributions–If you itemize, charitable contributions remain deductible. By making at least a portion of next year's contributions this year, you can enjoy a bigger tax benefit because of this year's higher rates.

4 State and local taxes–Sales tax is no longer deductible, but personal income and property taxes still are. What's more, you can pre-pay next year's state or local taxes and deduct the full amount from this year's federal taxes. With federal tax rates going down in 1988, you'll save money by pre-paying.

5 Consumer credit–Only 65 percent of consumer credit interest is deductible this year–but that drops to only 40 percent next year, 20 percent in 1989, 10 percent in 1990 and it will be fully disallowed in 1991. While debt still has its purpose, it is in your best interest to try to pay off as much of your consumer credit bills as you can this year.

6 Rental property repairs–If you own rental property, you may want to make repairs or do necessary maintenance now rather than waiting until next year–particularly if you expect to generate taxable income from the property. However if the property generates a loss, you should check to see if you will be able to use these deductions. Tax reform imposes limitations on the ability to deduct rental losses if your income exceeds certain levels.

SAVE NOW, PAY LATER

1 IRAs–An individual retirement account may be the average person's best tax break. You can shelter up to $2,000 of your earnings if single and up to $4,000 if married with a working spouse and you each earn at least $2,000. If you're married and your spouse doesn't work, you can still contribute up to $2,250. Any earnings on your account accumulate tax free until you withdraw your money. It may be the best deal in town.

However, there are limitations if either you or your spouse are eligible to participate in a pension or profit sharing plan. In this case, for every $1,000 you earn over $25,000 if single or $40,000 if married, you lose $200 in IRA deductions. That means if you're single, covered by a retirement plan and earn $30,000, you can still contribute up to $2,000, but only $1,000 will be deductible from your adjusted gross income.

2 401(k) plans–If it is available where you work, a 401(k) plan is probably the second best tax deal in town. You can contribute up to $7,000 of your income to your 401(k) account. Like an IRA, your 401(k) contribution reduces your gross income which in turn reduces your taxes and the earnings accumulate tax free until you withdraw them. Unlike an IRA, however, there are no income limits on a 401(k) plan. In addition, many employers offer partially matching contributions that add to the amount you contribute.

Bonus Tip: If a 401(k) plan is available where you work and your income doesn't exceed the IRA limits, you can fully deduct contributions to both. Not only can you significantly reduce your 1987 tax burden, you can also ensure that your retirement will be better funded.

3 Delay compensation–This strategy isn't for everyone, but it can work well for some people. If your highest marginal tax rate is going to be lower in 1988 than in 1987 and your employer allows it, you can postpone salary or bonus until next year. There is a caution, however. You must give up all rights to receive the compensation before you render any services. In order to qualify, you must not be entitled to receive the salary or bonus until next year.

4 Shift income–While this isn't actually deferring income, it can reduce your tax burden. It works this way: you transfer just enough of your income-producing assets (savings accounts, stocks, bonds, etc.) in each of your children's names to give each child $1,000 a year in unearned income. Children under 14 with no earned income, pay no taxes on the first $500 of unearned income and are taxed on the next $500 at their lower rate. Any unearned income over $1,000 is taxed at your highest marginal rate. Be advised that the asset must be in the child's name. You can't just ask your bank to deposit your interest in the child's account.

5 Tax-free income–It used to be that only millionaires bought tax-free bonds, but now the average person can take advantage of them as well. While the bonds themselves are usually sold in $5,000 denominations, you can purchase shares in a tax-exempt municipal bond mutual fund for as little as $500. The interest on the bonds is tax-free as long as the bonds were not issued to fund a private use project such as a stadium or arena. But before making any type of investment, you should consult with your financial planner. The planner can help you determine if tax-free bonds offer rates that are comparable with the after-tax yield of commercial bonds.

Bonus Tip: If you buy municipal bonds issued in the state where you live, the interest may also be free from state and local taxes.

6 Delay investment income–With tax rates higher this year than next, you'll want to delay receiving investment or interest income. Best way to do that is by selecting investments that don't pay off until next year.

1987 TAX RATES

INCOME TAX RATE SCHEDULES–1987

MARRIED TAXPAYERS

Joint/Surviving Spouse

Taxable Income	Tax	% on excess
$ 0	$ 0	11%
3,000	330	15%
28,000	4,080	28%
45,000	8,840	35%
90,000	24,590	38.5%

UNMARRIED TAXPAYERS

Single

Taxable Income	Tax	% on excess
$ 0	$ 0	11%
1,800	198	15%
2,500	303	15%
16,800	2,448	28%
23,000	4,184	28%
27,000	5,304	35%
38,000	9,154	35%
54,000	14,754	38.5%
80,000	24,764	38.5%

Head of Household

Taxable Income	Tax	% on excess
$ 0	$ 0	11%
1,800	198	11%
2,500	275	15%
16,800	2,420	15%
23,000	3,350	28%
27,000	4,470	28%
38,000	7,550	35%
54,000	13,150	35%
80,000	22,250	38.5%